TFSA and RRSP Total Returns: 1 Top Strategy for a Self-Directed Pension

Description

Canadians are increasingly responsible for building their own retirement fund. One strategy that has delivered attractive total returns over the years involves using dividends from top stocks to buy additional shares.

Power of compounding

As kids, we all learn that a small snowball can quickly become a massive snow boulder when rolled along the ground. That's how we make a snowman, and it is a great example of how the power of compounding works.

In the world of investing for retirement the same process can be applied to top stocks that pay reliable and growing dividends.

How?

Investors use the dividend payments to buy new shares. These, in turn, pay out even more dividends on the next distribution that can then be used to buy even more stock, and so on. The process is slow at the start, but over time, it can turn a small initial investment into a significant retirement fund. Market dips are less stressful when using this strategy, because they enable the purchase of new shares at lower prices.

Inside a TFSA or RRSP, the full value of the dividend can potentially be used to buy new stock. TFSA earnings and withdrawals are tax free. RRSP funds are only taxed when the money is removed, ideally when the person is at a lower marginal tax rate than when the contributions were initially made.

Top stocks to own tend to be industry leaders with long track records of dividend growth.

BCE

BCE (TSX:BCE)(NYSE:BCE) has been a favourite among income investors for decades due to its generous and reliable dividend, but the stock has also performed well for investors seeking total returns.

The communications giant has a wide competitive moat that it defends through investments in network upgrades and the deployment of new technology. BCE is running fibre optic lines right to the premises of its customers and is rolling out a 5G network.

The company has the balance sheet strength to make the billion of dollars of investments needed protect its position and can raise prices when it needs more cash to cover rising expenses. BCE provides essential services that people and businesses need regardless of whether the economy is on a roll or in a rut. This should make the stock a good defensive pick for a balanced dividend portfolio.

BCE raised the dividend by at least 5% annually for the past 14 years. The current distribution provides a 5.25% yield. The generous payout makes it attractive for a dividend-reinvestment strategy as well as for a portfolio focused on generating passive income. Investors will ideally have enough capital built up in the pension fund at some point to switch from buying new shares to taking the dividends as an earnings stream.

Long-term investors have done well with BCE stock. A $10,000 investment in the shares 25 years ago would be worth about $240,000 today with the dividends reinvested. At the current yield of 5.25%, that initial $10,000 investment would now generate $6,000 per year in dividends!

The bottom line on investing for retirement

Harnessing the power of compounding is a proven strategy for building retirement wealth. BCE is just one example of a top TSX stock that would be a good anchor pick for a diversified self-directed TFSA or RRSP portfolio.

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